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SUBJECT: TURKEY: NEW GOT TAX IMPLEMENTATION UPSETS FREE TRADE ZONES

¶1. (U) Summary: A recent communique issued by Turkish Customs levies additional taxes against companies operating in Free Trade Zones. This unforeseen change in tax policy substantially increased production costs in these zones. The Aegean Free Trade Zone, which has majority U.S. ownership, was adversely affected by this new decision. Deputy Prime Minister Hayati Yazici, who holds responsibility for Customs, reportedly visited ESBAS on February 7 and directed Customs personnel to resolve this problem. Even if there is a timely solution, however, this type of arbitrary and unexpected policy change sends a bad signal to potential investors at a time when Turkey is trying to attract greenfield investment. End summary.

¶2. (SBU) Turkish Customs issued a circular on January 21, 2008, that required the companies operating in Free Trade Zones (FTZ) to pay Value Added Tax (VAT) on the goods they buy for investment, consumption and internal use. Customs based its circular on a 1999 law that called for all VAT-free materials entering into the FTZs to be used for production purposes. The law states that materials to be used for consumption must pay regular VAT. To date, the companies operating in FTZs have been exempt from all taxes, based on the 1985 legislation creating these zones. Although the VAT legislation was passed in 1999, it has not been applied before to companies operating in the FTZs. On January 21, however, Customs officers started inspecting all trucks bringing goods into these zones and requiring companies to pay VAT on materials they use for internal consumption purposes. With the new and unexpected requirement to pay VAT on all operating expenses, including fuel for heating, the companies face significant cost overruns that have already caused some to stop production.

¶3. (SBU) The new requirements had a serious negative impact on the Aegean Free Trade Zone (ESBAS), which is majority owned by the American company EAC Turkey International. ESBAS Marketing Coordinator Ertugrul Isiksoy stated that this new interpretation of the law has caused significant problems to the companies operating in ESBAS, including interruptions in production and reluctance to make additional investment in the zone, which currently boasts 55 million Euro worth of investment. Isiksoy said Customs officers at the entrance to ESBAS have refused entry to trucks carrying construction material for new facilities until companies agree to pay VAT on these goods. "Even the fuel our companies use for heating purposes is subject to VAT now," complained Isiksoy, "which imposes substantial a cost burden on them." Isiksoy noted that Deputy Prime Minister Hayati Yazici, who oversees Customs, visited ESBAS on February 7, and directed his staff to find an immediate solution to the problem.

¶4. (SBU) Comment: In recent years, the GOT has been taking important steps to improve its investment environment. While the related changes in legislation brought positive developments such as faster and more efficient company establishment procedures and a streamlined bureaucracy focused on investment, the Turkish government must consider the investment implications of unexpected and arbitrary shifts in policy. Such drastic changes that affect

the operating costs of companies will only send a bad signal to
companies looking to invest in Turkey. End comment.
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